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Current activities of international organizations related to the harmonization and unification of law relating to Security Interests

Note by the Secretariat*

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* The late submission of the document reflects the need to await completion of the 11th session of Working Group VI (1-5 May 2006).

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I. Introduction

1. At its thirty-third session in 2000, its thirty-seventh session in 2004 and thirty-eighth session in 2005, the Commission considered coordination of international organizations in the area of security interests on the basis of notes prepared by the Secretariat (A/CN.9/475, A/CN.9/565 and A/CN.9/584 respectively). This note updates the information included in these notes. It focuses on activities of international organizations primarily undertaken since 2000 to develop harmonized and unified international trade law instruments in the area of secured credit law and is based upon publicly available material and, to the extent possible, consultations undertaken with the listed organizations.

2. The work of the following organizations is described in this report:

(a) United Nations bodies and specialized agencies:

WIPO	World Intellectual Property Organization

(b) Other intergovernmental organizations:

EBRD	European Bank for Reconstruction and Development
European Commission	Commission of the European Union
Hague Conference	Hague Conference on Private International Law
OAS	Organization of American States
Unidroit	International Institute for the Unification of Private Law
World Bank	International Bank for Reconstruction and Development

II. Harmonization and unification of law relating to security interests

A. UNCITRAL[1]

3. Recognizing the importance of access to affordable credit to economic growth and international trade, the Commission at its thirty-fourth session in 2001 established a Working Group on security interests to develop a flexible and effective legal framework for secured credit.[2] At its thirty-fifth session in 2002, the Commission confirmed the mandate given to Working Group VI (Security Interests) and affirmed that the mandate should be interpreted widely to ensure an appropriately flexible work product, in the form of a legislative guide.[3] The Working Group, in the context of the mandate given by the Commission, decided to extend the scope of the draft legislative guide ("the draft Guide") to receivables, proceeds of letters of credit, bank accounts, negotiable documents, negotiable instruments and intellectual property rights.[4]

4. So far, the Working Group has held nine sessions and developed chapters on key objectives, scope, approaches to security, creation, third-party effectiveness, priority, enforcement, insolvency, acquisition financing, conflict of laws and transition.[5] In addition, the Working Group has held two joint sessions with the UNCITRAL Working Group on Insolvency (which was developing and has now completed the Legislative Guide on Insolvency Law) to discuss the insolvency chapter of the draft Guide.[6]

5. The Working Group has also worked closely with the Hague Conference in the formulation of the chapter on conflict of laws of the draft Guide. In addition, the Working Group has coordinated with Unidroit, which is preparing a text on intermediated securities (see paras. 6-16), and with the World Bank, which has finalized a set of principles for effective insolvency and creditor rights systems.

B. Unidroit[7]

1. Draft convention on substantive rules regarding intermediated securities

6. Unidroit is currently preparing a draft convention on substantive rules regarding intermediated securities ("the draft Convention"). The first and second meetings of the committee of governmental experts were held in Rome from 9 to 20 May 2005 and from 6 to 14 March 2006, respectively. A third meeting is scheduled for November 2006.

7. At the second meeting of governmental experts, it was agreed that the two secretariats will cooperate and report to their respective bodies on issues of common interest and in particular on the treatment of proceeds of intermediated securities that take the form of assets within the scope of the draft Guide or of proceeds of assets within the scope of the draft Guide that take the form of intermediated securities.

8. The Commission may wish to note that securities (in general, not only intermediated securities that are the subject of the draft Convention) are excluded from the scope of the draft Guide as original encumbered assets.[8] However, securities may be affected by the recommendations of the draft Guide in two instances.

9. First, if a security right in securities secures a receivable, negotiable instrument or other obligation and the receivable is assigned or a security right is created in the negotiable instrument or other obligation, a security right is automatically created in the securities and becomes automatically effective against third parties. This rule does not affect any third-party rights, priority or enforcement requirements existing under securities law.[9] For example, under the draft Convention a security right in intermediated securities that was made effective against third parties by a book entry or control under securities law will have priority over a competing right that was made effective under other law.[10]

10. In addition, securities may be affected by the recommendations of the draft Guide if they constitute proceeds of an asset covered in the draft Guide (e.g. inventory or funds in a bank account). The security right in the original encumbered assets continues in the proceeds.[11] A separate act is not necessary for the security right in the proceeds to be effective against third parties.[12]

11. In order to better reflect the fact that securities and other assets outside the scope of the draft Guide may be affected by the draft Guide, the Secretariat suggested that the Working Group may wish to consider whether a qualified exclusion leaving securities outside the scope of the draft Guide only to the extent there is special legislation would be more appropriate than an outright exclusion which would leave securities out of the scope of the draft Guide even if there is no such special legislation, thus leaving a gap in the law.[13]

12. If the Working Group were to adopt this approach, methods of achieving third-party effectiveness (e.g. a book entry or a control agreement) other than registration would need to be preserved and a new recommendation may need to be added to preserve the priority of rights made effective against third parties through one of these special methods.

13. Such an approach would be consistent with the approach followed in the draft Guide with respect to attachments to immovable property or movable property subject to a specialized registration or title certificate system. Under this approach, a security right in attachments to immovable property is subordinate to a security right in the relevant immovable property or in the relevant movable property subject to a specialized registration or title certificate system, unless it is registered first in the immovable registry or in the specialized registry or is noted on the relevant title certificate, as applicable.[14]

14. In addition, this approach would be consistent with the draft Convention, under article 6 (1) of which a security right in securities (as original encumbered assets or as proceeds) that was made effective against third parties under the draft Convention has priority over a security right that was made effective against third parties under law outside the draft Convention (e.g. a law based on the recommendations of the draft Guide). The rationale underlying this approach is that the book entry or control related system established by the draft Convention could not be relied upon if a security right in intermediated securities created and perfected under other law had priority over a security right made effective against third parties under the draft Convention.

15. Moreover, this approach would avoid excluding from the scope of the draft Guide directly held securities to the extent they are not subject to any special legislation (even the Unidroit draft Convention does not apply to directly-held securities). Thus, no gap would be left with respect to, for example, security rights in shares of a subsidiary all held by the parent company, since such security rights are involved in many commercial loan transactions.

16. A different issue is what law applies to proceeds of securities that are within the scope of the draft Guide (e.g. securities are sold and the proceeds are deposited in a bank account). It seems that, if proceeds of bank accounts in the form of securities should be subject to the law governing securities, proceeds of securities in the form of funds in a bank account should be subject to the law governing security rights in funds credited to bank accounts, at least with respect to third-party effectiveness, priority and enforcement of a security right. This approach seems to be consistent with the approach followed in the draft Convention, since, if a secured creditor has obtained a control agreement, the account holder cannot dispose of or encumber the securities without the consent of the secured creditor. If the secured creditor does not obtain a control agreement or has authorized further dispositions

or encumbrances by the account holder, the secured creditor cannot claim priority over another secured creditor with a security right in proceeds from the disposition of the securities credited to a bank account. As this is the result of consultations with experts familiar with the draft Convention, it may need to be further examined and confirmed.

17. The Commission may wish to note this matter and request the Working Group to submit its proposals with the rest of the draft Guide, which is expected to be adopted by the Commission at its fortieth session in 2007.

2. Principles and rules on trading in securities in emerging markets

18. Unidroit is preparing an instrument on principles and rules capable of enhancing trading in securities on emerging markets. Work is envisaged to start in decentralized, regional working groups in 2006.

3. Draft model law on leasing

19. Unidroit is undertaking the drafting of a model law on leasing ("the draft Model Law") in cooperation with the International Finance Corporation, aimed in particular at assisting developing countries and economies in transition. A special advisory board has already held three sessions in Rome (its first from 17 to 18 October 2006, its second from 6 to 7 February 2006 and its third from 3 to 5 April 2006). At its third session, the advisory board considered the second preliminary draft of the Model Law,[15] as well as comments and suggestions by the UNCITRAL secretariat to avoid overlap and conflicts between the draft Model Law and the draft Guide.[16]

20. The overlap and conflicts between the draft Model Law and the draft Guide are the result of the fact that both texts cover leases that serve security purposes (i.e. financial leases) treating them differently.[17] For example, as a result of articles 1 and 3 of the draft Model Law, in effect registration is referred to the law of the State where the encumbered/leased asset is located, the law of the State where the grantor/lessee has the centre of its main interests, or the law of the State whose law governs the security/lease agreement. Such a result would be inconsistent with recommendation 136 of the draft Guide,[18] according to which the law applicable to the creation, third-party effectiveness (including registration) and priority of a security right (including the right of a financial lessor) in movable property would be the law of the State where the encumbered/leased asset is located (exceptions apply to leases in mobile equipment and to leases in movable property that is subject to title registration[19]).

21. At the third session of the advisory board in April 2006, it was indicated that implementation notes might be the way to address the conflict of the draft Model Law with current secured transactions laws that treat financial leases as secured transactions, as well as with the law of countries that will adopt the recommendations of the draft Guide in the future.[20] It is doubtful that this would be sufficient. More importantly, this approach would not address the concern that a special law that covers financial leases, i.e. a transaction that performs security functions, could detract from the approach recommended in the draft Guide that countries should adopt a law that systematically and comprehensively covers all transactions that perform security functions.

22. The draft Model Law is expected to be submitted to the Governing Council at its meeting to be held in Rome from 8 to 11 May 2006 for consideration of the most appropriate follow-up action. The Secretariat of Unidroit is expected to recommend that the draft Model Law be submitted to Governments for finalization at a special conference in October 2006 and then at an extraordinary session of the Unidroit General Assembly to be held in Rome from 27 to 29 November 2006.[21]

23. The Commission may wish to consider this matter and recommend that the draft Model Law exclude financial leases, or, if financial leases were to be included, the Model Law (i) be limited to contractual issues or (ii) defer to secured transactions law or (iii) be coordinated with the recommendations of the draft Guide.

4. Protocols to the Cape Town Convention

24. Unidroit, jointly with the Intergovernmental Organization for International Carriage by Rail (OTIF),[22] is finalizing the second Protocol to the Convention on International Interests in Mobile Equipment (Cape Town, 16 November 2001),[23] that deals with matters specific to railway rolling stock (the draft Rail Protocol). The Rail Registry Task Force established to prepare an international registry system and related aspects submitted the draft Rail Protocol to the Unidroit Governing Council in April 2005. The Protocol is to be submitted for adoption by a diplomatic conference in the near future.

25. A third protocol to the Cape Town Convention dealing with matters specific to space assets (a preliminary draft Protocol to the Cape Town Convention on International Interests in Mobile Equipment on Matters specific to Space Assets) is being drafted. The third session of the committee of governmental experts is scheduled to be held in Rome in September/October 2006. Additional protocols that may cover agricultural and construction equipment are also under consideration.

C. Hague Conference[24]

26. A commercial edition of the Explanatory Report on the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary (Hague Securities Convention) was published in 2005. The Report provides the most authoritative and comprehensive explanations of the Convention and is available on the website of the Hague Conference.[25] The Hague Conference continues to work closely with UNCITRAL on the conflict-of-laws chapter of the draft Guide.

D. EBRD[26]

27. In 2004, in the context of its work on the modernization of secured transactions legislation, the EBRD published the EBRD Guiding Principles for the Development of a Charges Registry.[27]

E. European Commission[28]

1. The financial collateral, the late payment and the settlement finality directives

28. The European Commission issued a Financial Collateral Arrangements Directive on 6 June 2002 to improve the legal certainty of financial collateral arrangements,[29] a Directive on Combating Late Payment in Commercial Transactions on 29 June 2000,[30] and a Settlement Finality Directive in May 1998.[31] The Secretariat received informal comments and suggestions from the European Central Bank on the relationship between the draft Guide's recommendations on bank accounts and these directives. The conclusion seems to be that there is no conflict between the recommendations in the draft Guide and these directives.[32]

2. The proposal for a regulation on the law applicable to contractual obligations (Rome I)

29. At its thirty-seventh session in 2004, the Commission noted efforts in the European Commission towards development of a new community instrument in which the issue of the law applicable to third party effects of assignments, which had been settled in article 22 of the United Nations Convention on the Assignment of Receivables in International Trade (the "United Nations Assignment Convention") by reference to the law of the State in which the assignor was located, would be addressed.

30. At that session, it was widely felt that the rule in article 22 of the United Nations Assignment Convention provided certainty for third parties and thus would most likely increase the availability and reduce the cost of credit and that adoption of a different rule by the European Union would not only have a negative impact on the availability and the cost of credit but would also produce disharmony in trade relationships involving European Union parties and non-European Union parties, where a priority dispute was brought before a court in a non-European Union country.

31. At the same session, a number of States, including Member States of the European Union, indicated that they were considering ratifying or acceding to the United Nations Assignment Convention and that, as a result, had a great interest in seeing the European Union adopt an approach to the issue of the law applicable to third party effects of assignments that would be consistent with the approach followed in article 22 of the United Nations Assignment Convention. In the discussion, strong support was expressed for holding a coordination meeting that would involve representatives of the European Commission, UNCITRAL and relevant industry to resolve the matter as soon as possible so as to remove any obstacle to wide adoption of the United Nations Assignment Convention.

32. After discussion, the Commission recommended that every effort be made to avoid that a future European Union instrument taking a different approach than article 22 of the United Nations Assignment Convention and requested the Secretariat to organize a meeting with representatives of the European Commission, Member States and industry with a view to resolving that matter as soon as possible.[33]

33. The Secretariat held informal consultations with the Justice and Home Affairs Directorate of the European Commission responsible for Rome I with a view to: (i) ensuring that the new European Union instrument will be consistent with the United Nations Assignment Convention; and (ii) facilitating adoption of the United Nations Assignment Convention by European Union Member States. The Secretariat also informed the European Commission about UNCITRAL's request to hold a coordination meeting. However the meeting has not taken place so far.

34. On 15 December 2005, the European Commission published its proposal (COM (2005) 650 final, 2005/0261) for a regulation of the EU Parliament and the Council on the law applicable to contractual obligations (Rome I). Article 13 (3) adopts the law of the assignor's habitual residence for third-party effects of assignment. According to the comment to article 13 (3), the approach adopted is the approach of the United Nations Assignment Convention. Article 18, however, defines habitual residence by reference to the principal place of business (the term "establishment" is used) and, if there is a branch office, the location of the branch office. There is no comment to article 18 pointing out the difference with the location rule in the United Nations Assignment Convention (referring to the place of the assignor's central administration), as a result of which the law applicable under the proposed regulation article 13 (3) may be different from the law applicable under article 22 of the United Nations Assignment Convention.

35. The Commission may wish to consider the matter and recommend that increased efforts be made through informal or formal consultations and meetings to ensure consistency between the proposed regulation and the Assignment Convention and, in any case, to facilitate adoption of the United Nations Assignment Convention by European Union Member States.

F. OAS[34]

36. The OAS, through its sixth Inter-American Specialized Conference on Private International Law (CIDIP VI), held in 2002, adopted the Model Inter-American Law on Secured Transactions. The thirty-fifth regular session of the OAS General Assembly held in June 2005 approved the agenda items for CIDIP VII, which includes further work on the development of uniform Inter-American registration forms as well as regulatory guidelines for secured transactions registries, and the electronic operation thereof, for implementation in conjunction with the Model Law.[35]

37. This work will be conducted by governmental experts on an internet-based forum. The group of experts has the mandate to negotiate and draft three Inter-American instruments on electronic registries: (i) Uniform Registration Forms; (ii) Guide for Personal Property Collateral Registries; and (iii) Guide for Electronic Registries. Preparatory work will commence in June 2006 with a discussion of five Uniform Registration Forms. Although most features of the forum are public, the ability to add comments and remit documents is reserved to designated experts, including designated members of the UNCITRAL secretariat.[36]

38. The Commission may wish to take note of this work and request the secretariat to follow this OAS project and report to the Commission in due course.

G. WIPO[37]

39. WIPO is providing a forum for ad hoc discussions by intellectual property experts on the issue of intellectual property financing secured transactions and intellectual property rights. These discussions include an examination of the effect of the recommendations in the draft Guide on intellectual property rights.

40. The draft Guide recognizes the importance of intellectual property rights as a source of credit, either as original collateral or as incidental collateral (i.e. where the collateral is equipment including intellectual property rights). In the latter case, the collateral would be useless if the security right did not include a licence to use or sell the equipment (which would be the case if the collateral were, for example, computers incorporating software subject to copyright).

41. Accordingly, the draft Guide provides that its recommendations apply to security rights in intellectual property rights to the extent that the recommendations are not inconsistent with existing laws or international obligations of the enacting State relating to these assets. The draft Guide also calls the attention of enacting States to the need for them to consider whether it might be appropriate to adjust certain of the recommendations as they apply to security rights in intellectual property. The Working Group considered that the draft Guide could not specifically address those adjustments since to do so would require substantial work that would go beyond the time available to the Working Group for the completion of its work (early in 2007 for submission to the 2007 Commission session).

42. For that reason, the WIPO and UNCITRAL secretariats have conducted consultations with a view to undertaking further collaborative work in the area of intellectual property in the context of the draft Guide. A joint meeting of experts in secured transactions and intellectual property is scheduled for September 2006. The purpose of this meeting is to formulate proposals to the Commission for an additional chapter or appendix to the draft Guide that would deal with security rights in intellectual property rights.

43. The Commission may wish to take note of this preparatory work and request the secretariat to submit a note on the matter for consideration at the fortieth session of the Commission in 2007.

H. World Bank[38]

44. The Investment Climate Department of the World Bank informed the secretariat of its plan to prepare, with the assistance of outside consultants, a manual for reforming collateral systems in the area of secured finance, which is aimed at assisting task managers who are working with countries to support the reform of the legal and institutional frameworks for secured lending.

45. The Commission may wish to request the secretariat to monitor developments in this regard with a view to avoiding overlap and conflict between this text and the draft Guide.

Notes

[1] http://www.uncitral.org.

[2] Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17 (A/55/17), para. 459.

[3] Fifty-seventh Session, Supplement No. 17 (A/57/17), para. 204.

[4] Fifty-seventh Session, Supplement No. 17 (A/57/17), para. 222.

[5] See http://www.uncitral.org for reports of the Working Groups (A/CN.9/512, A/CN.9/531, A/CN.9/532, A/CN.9/543, A/CN.9/549, A/CN.9/570, A/CN.9/574, A/CN.9/588 and A/CN.9/593).

[6] Fifty-eighth Session, Supplement No. 17 (A/58/17), para. 217. See http://www.uncitral.org/uncitral/en/commission/working_groups/5Insolvency.html for reports A/CN.9/535 and A/CN.9/550 on joint sessions of the Working Groups on security interests and insolvency law.

[7] http://www.unidroit.org.

[8] See A/CN.9/WG.VI/WP.26/Add.7, rec. 4 (a) and (b).

[9] See A/CN.9/WG.VI/WP.26, rec. 16.

[10] This is the result under art. 5 (3) and 10 (1) of the draft Convention. See Study LXXVIII-Doc. 42, March 2006.

[11] See A/CN.9/WG.VI/WP.26/Add.4, recs. 29 and 30.

[12] See A/CN.9/WG.VI/WP.26/Add.4, recs. 41 and 41 bis.

[13] See A/CN.9/WG.VI/WP.26/Add.7, note to rec. 3 (g).

[14] See A/CN.9/WG.VI/WP.26/Add.4, recs. 46, 46 bis, 82, 83, 84 and 84 bis.

[15] See Unidroit 2006, Study LIXA-Doc. 6, March 2006.

[16] See Unidroit 2006, Study LIXA-Doc.7, March 2006.

[17] See Unidroit 2006, Study LIXA-Doc.8, art.1, as well as A/CN.9/WG.VI/WP.26/Add.7, rec. 3 (c) and (e), as well as definition of "acquisition security right" in A/CN.9/WG.VI/WP.24/Add.5.

[18] See A/CN.9/WG.VI/WP.24.

[19] See A/CN.9/WG.VI/WP.24. For more examples of conflicts between the two texts, see Unidroit 2006, Study LIXA-Doc.7, March 2006, Comments by the UNCITRAL secretariat.

[20] See, for example, Unidroit 2006, Study LIXA-Doc.9, comment 3 on article 2, comment C on article 3, comment B on article 7.

[21] See Unidroit 2006, Study LIXA-Doc.9, future work.

[22] http://www.otif.org.

[23] The Convention entered into force on 1 April 2004. UNIDROIT performs depositary functions under the Cape Town Convention and its Protocol on Matters Specific to Aircraft Equipment Instruments (Cape Town, 16 November 2001) (the "Aircraft Protocol"). In such capacity, it oversees the development of an International Registry for aircraft objects as provided by the Aircraft Protocol.

[24] See http://www.hcch.net.

[25] http:// www.hcch.net.

[26] http://www.ebrd.com.

[27] http://www.ebrd.com/country/sector/law/st/new/develop/index.htm.

[28] http://europa.eu.int.

[29] http://europa.eu.int/scadplus/leg/en/lvb/l24401.htm.

[30] http://europa.eu.int/comm/enterprise/regulation/late_payments/index.htm.

[31] http://europa.eu.int/comm/internal_market/financial-markets/settlement/index_en.htm. The Settlement Finality Directive was adopted in May 1998.

[32] http://europa.eu.int/comm/internal_market/financial-markets/settlement/index_en.htm. The Settlement Finality Directive was adopted in May 1998.

[33] See Official Records of the General Assembly, Fifty-ninth Session, Supplement No. 17 (A/59/17), paras. 104-107.

[34] http://www.oas.org.

[35] http://www.oas.org/main/main.asp?sLang=E&sLink=http://www.oas.org/dil/.

[36] http://www.oas.org/dil/esp/derecho_internacional_privado_foro_garantias_mobiliarias.asp.

[37] http://www.wipo.int.

[38] http://www.worldbank.org.